Supreme Court, U. S.
FILED
JUN 29 1979
MICHAEL RODAK, JR., CLERK

No. 78-1753

In the Supreme Court of the United States

OCTOBER TERM, 1978

JAMES C. TOOKE and BILLIE A. TOOKE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1753

JAMES C. TOOKE and BILLIE A. TOOKE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner James C. Tooke[1] seeks review of the decision below in this federal income tax case upholding the Commissioner's disallowance of certain partnership deductions as bribes to public officials and requiring the inclusion in income of various payments in return for his services in obtaining favorable property tax treatment for clients of the partnership.

1. The pertinent facts are as follows: During 1959-1964, petitioner was engaged in the property tax consulting business as a sole proprietor and as a member of a partnership of Dawson, Desmond, Van Cleve and Tooke

---

[1]"Petitioner" refers to James C. Tooke. Billie A. Tooke is a party solely because of having filed joint returns with her husband.

(I-R. 112, 197).[2] Under the original version of the partnership agreement (Ex. 11-K), petitioner agreed to work full-time for the partnership in exchange for salary from the first $15,000 of the partnership's profits, plus one-third of the profits in excess of that amount. In addition, the partners agreed that petitioner would receive $25 per week as "escaping costs," designed to cover petitioner's "expenses incident to the conduct of business for which he would not be directly reimbursed because of the difficulty of accurate accounting" (Ex. 14-N). In October 1960, the partnership agreement was modified to reduce petitioner's salary from $15,000 to $13,700, and to grant petitioner a sales commission of 10 percent, decreasing to 5 percent after three years (Ex. 12-L). The partnership maintained a systems and procedures manual which, together with its financial statements, provided petitioner with sufficient data to determine the partnership's income, expenses and profit distributions (Pet. App. A 4-5).

During the years at issue, petitioner and his partnership made various illegal bribes to local public officials in order to secure low property tax assessments for their clients. The partnership claimed business expense deductions for all of these illegal payments under the categories of handling costs, professional fees or services. Petitioner claimed a pro rata share of these expense deductions on his tax returns (I-R. 128; Pet. App. A 14-15; Exs. 132 BBB BBB, 133 CCC CCC, 134 DDD DDD, 135 EEE EEE, 136 FFF FFF). As a result of these illegal payments, petitioner and his partners were convicted of various state criminal violations (Pet. App. A 7-8).

[2] "I-R." and "III-R." respectively refer to Volumes One and three of the record in the court of appeals.

On audit of petitioner's tax returns for 1959-1964, the Commissioner determined, *inter alia*, (1) that the "escaping costs" paid to petitioner by the partnership were includable in his gross income; (2) that certain payments received by petitioner from the partnership were taxable salary or sales commissions; (3) that $2,600 in kickback income that petitioner received in 1960 was taxable to him; and (4) that the disallowance of certain partnership deductions as bribes to public officials resulted in an increase in petitioner's share of partnership income. The Tax Court upheld the Commissioner's determinations (Pet. App. A 30-41), and the court of appeals affirmed (Pet. App. B).

2. The decision below correctly upheld the Commissioner's adjustments to petitioner's income. Petitioner argues (Pet. 6-10) that the payments made by the partnership to petitioner were nontaxable distributions under Section 731 of the Internal Revenue code of 1954. But Section 731 governs only those partnership distributions made to a partner in his capacity as a member of the partnership. Thus, in order to qualify as a nontaxable distribution under Section 731, the distribution must be either contributed capital or previously taxed profits. Compare Section 707. But where, as here, a partnership makes payments to a partner other than in his partnership capacity (*e.g.*, for services rendered to the partnership), Section 731 does not come into play. In such circumstances, the payments are taxable to the recipient partner as "guaranteed payments" (Section 707; H.R. Rep. No. 1337, 83d Cong., 2d Sess. A226 (1954)) and are deductible by the partnership as ordinary and necessary business expenses.

Here, the "escaping" costs were paid to petitioner in connection with his services in securing additional business for the partnership. Since they were paid to him

other than in his capacity as a partner and without regard to the income of the partnership, they were "guaranteed payments" under Section 707(c).[3] Since petitioner did not meet his burden of proving that he incurred any expenses for which he required reimbursement,[4] the payments were taxable to him. See, *e.g.*, *United States* v. *Fahey*, 510 F. 2d 302, 305 (2d Cir. 1974); *Turner* v. *Commissioner*, 56 T.C. 27, 33 (1971); *Yeomans* v. *Commissioner*, 5 T.C. 870, 875 (1945).

The decision below likewise correctly held that petitioner's sales commission, salary and kickback income were includable in his gross income under Section 61(a)(1) as "compensation for services, including fees, commissions, and similar items." The sales commissions were payable separate from and without regard to the income of the partnership, and were intended to compensate him for his full-time services in bringing in new clients for the partnership (I-R. 83; III-R 268). Thus, petitioner "earned" this income through his personal efforts. "[T]he first principle of income taxation [is] that income must be taxed to him who earns it" (*Commissioner* v. *Culbertson*, 337 U.S. 733, 739-740 (1949)), and "that principle applies with equal force in assessing partnership income" (*United States* v. *Basye*, 410 U.S. 441, 451 (1973)). Accord: *Lucas* v. *Earl*, 281 U.S. 111 (1930). The salary payments made to petitioner were similarly intended as further compensation

[3]Petitioner errs in arguing (Pet. 7) that the payments were made to him as a member of the partnership. Section 707(c) specifically provides that if payments determined without regard to the income of the partnership are made to a partner for services rendered, they "shall be considered [for purposes of computing a partner's gross income] as made to one who is not a member of the partnership."

[4]See *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935): "Unquestionably the burden of proof is on the taxpayer to show that the commissioner's determination is invalid."

for his services to the partnership and were therefore taxable to him. Petitioner failed to show that any portion of these salary payments represented a nontaxable distribution of capital or previously taxed partnership profits. Indeed, since the $2,600 kickback was not even paid to petitioner by the partnership, it could not by any stretch of the imagination qualify as a nontaxable partnership distribution under Section 731.

Finally, petitioner argues (Pet. 9-12) that the Commissioner is barred from disallowing the deduction of certain payments by the partnership as illegal bribes unless he first establishes that the partnership actually claimed the bribes as deductions on its tax returns. But contrary to petitioner's claims (Pet. 10), the record shows that the partnership did in fact deduct the illegal bribes under various categories such as "professional fees," "handling costs" and "services costs" (Exs. 132 BBB BBB, 133 CCC CCC, 134 DDD DDD, 135 EEE EEE, 136 FFF FFF), and the Tax Court's findings reflect that fact (Pet. App. A 14). At all events, it is well settled that the Commissioner can make an adjustment to a partner's return without first having examined his partnership's returns or books and records. *Chaum* v. *Commissioner*, 69 T.C. 156 (1977). See also *Bunnel* v. *Commissioner*, 50 T.C. 837 (1968).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

JUNE 1969

DOJ-1979-06